

**HEARING ON WAYS AND MEANS SMALL BUSINESS AND PASS-THROUGH
ENTITY TAX REFORM DISCUSSION DRAFT**

SUBCOMMITTEE ON SELECT REVENUE MEASURES

COMMITTEE ON WAYS & MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

Written Comments for alliantgroup

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Introduction

Chairman Tiberi, Ranking Member Neal, and distinguished Members of the Subcommittee, thank you for the opportunity to submit written comments regarding the Small Business and Pass-Through Entity Tax Reform Discussion Draft.

My name is Dean A. Zerbe and I am National Managing Director, Washington D.C. for alliantgroup. alliantgroup serves a broad spectrum of clients, from start-ups to the largest Fortune 1000 companies in nearly every industry. Our professionals consist of CPAs (including former Big 4 partners) and attorneys, in addition to individuals from a wide array of disciplines. alliantgroup works with businesses and their CPA firms to identify powerful, government-sponsored, cash-generating credits, incentives, and deductions. Previously I served as Senior Counsel and Tax Counsel for the Senate Finance Committee.

Testimony

It is critically important to the nation's economy and to your constituents that Congress helps small and medium businesses remain and become financially viable. Small changes to the tax code can be the way more employees get hired; more equipment is bought, built or exported. Small changes are HUGE game changers for small businesses.

A number of countries provide additional incentives for small and medium-size enterprises. By contrast, the U.S. R&D tax credit provides no additional incentives for small and medium businesses. In fact, U.S. tax policy actually erects barriers that limit these businesses from enjoying the incentives of the R&D tax credit.

The negative impact of these barriers is made clear by the findings of the GAO 2009 report to the Committee on the R&D tax credit which highlighted the small amount of overall dollars of the R&D tax credit that go to small and medium businesses.

We encourage you to support the following changes to IRC Sec. 41, the Research and Development tax credit:

- **INCREASE IN THE AMOUNT OF THE R&D CREDIT**

Increasing the amount of the credit from 14% to 20% will have an enormous REAL impact on small businesses. It could mean the difference between the status quo or hiring a new employee or purchasing new capital.

- **ALLOW THE R&D TAX CREDIT AGAINST THE AMT**

The biggest barrier for small and medium businesses taking the R&D credit is that the credit cannot be used to reduce the business owners' alternative minimum tax (AMT). This means, that a business owner of a pass-thru entity that is subject to the AMT cannot use the R&D credit to reduce her taxes. 8 out of 10 businesses that would otherwise benefit from taking the R&D credit will receive little to no benefit from the R&D credit because the credit cannot be used to reduce AMT. Given that the vast majority of small and medium businesses are organized as pass-thru entities, the potential benefit of the R&D tax credit to encourage innovation and create jobs is greatly diminished.

The Senate Finance Committee made the right policy call in allowing the R&D tax credit to be taken against AMT in enacting the Small Business Jobs Act of 2010. The only drawback is that this legislation was good for only one year – 2010.

- **ALLOW TAXPAYERS TO ELECT ASC ON AN AMENDED RETURN**

As the Committee proposes to change the R&D tax credit to allow solely for the alternative simplified credit (ASC), it is vital that the statute make clear that the ASC can be elected by businesses on amended returns. Currently, businesses can elect to take only the traditional R&D tax credit on an amended return not the ASC.

Congress created the ASC in Section 104 of the Tax Relief and HealthCare Act of 2006 (P.L. 109-432). The ASC was intended to broaden the number of companies that would be eligible to take advantage of the incentives provided by the R&D tax credit.

The policy intent of the ASC – expanding the number of companies eligible for the R&D tax credit – has been largely successful. The ASC has been especially beneficial for small and medium companies that could not take the regular R&D tax credit because of difficulties with the base years (and often substantiating expenditures in the base years).

However, a significant limitation for businesses – especially small and medium businesses – is the restriction in the *regulations*, published temporarily in 2008 and made permanent earlier this year, that do not allow a taxpayer to elect the ASC on an amended return. 1.41-9(b)(2) (“An election under section 41(c)(5) may not be made on an amended return.”). There is nothing in the statute that requires such a limitation.

Thousands of companies that are performing activities that qualify for the R&D tax credit are being prevented by this regulation from benefitting fully from this important tax credit – and at times are discouraged from even taking the ASC on their current return.

Therefore, because of this regulation, thousands of our nation's most innovative small and

medium businesses are not receiving the assistance intended by Congress through the R&D tax credit.

- **ALLOW NEW AND SMALL BUSINESSES TO TAKE THE R&D CREDIT AGAINST THE EMPLOYER PAYROLL TAX**

While the AMT exclusion for the R&D tax credit would greatly benefit a large number of small and medium businesses, many *start-ups* would still be ineligible for the credit because they are not making a profit. The R&D credit is largely a wage-based credit - the only wage-based credit in the tax code. Allowing certain companies to take the credit against payroll taxes allows that company to both take advantage of the credit, but also increase its cash flow, as payroll is monthly, not annual.

Several states, and particularly Louisiana, Minnesota, New York and Arizona have had great success with an R&D tax credit that is provided even if a company doesn't owe income tax.

The Committee needs to bear in mind that while the engines for job growth are small and medium businesses, it is particularly new businesses that are key to an increase in jobs. A great deal of innovation is concentrated in new businesses. Therefore, an R&D credit that is also available to new businesses will bolster both innovation and jobs.

An R&D tax credit – refundable against payroll taxes paid by companies – and capped at \$250,000 could provide much-needed cash for credit-starved innovative start-ups. Such a proposal would ensure that some of our most cutting edge new companies would actually receive the benefit of the R&D tax credit – as opposed to being on the outside looking in.

- **A MORE GENEROUS TAX CREDIT IF MANUFACTURED IN THE U.S.**

A policy goal of the R&D tax credit is to also support domestic manufacturing. The committee should encourage R&D that translates into U.S. manufacturing jobs by providing a greater credit to those companies that conduct a significant percentage of their manufacturing domestically.

An enhanced R&D credit for domestic manufacturers would particularly benefit small and medium businesses that rarely have manufacturing facilities outside the U.S. We encourage Congress to consider a 25% bonus in the R&D tax credit for U.S. companies that conduct a significant percentage of their manufacturing in the U.S. Such a credit would potentially create tens thousands of manufacturing jobs domestically and discourage companies from moving offshore.

- **A MORE GENEROUS R&D CREDIT FOR ENERGY EFFICIENT RESEARCH**

Special kinds of R&D, particularly the kind of grassroots R&D that provides the building blocks for other R&D (products or processes that create products that exceed industry standards for energy efficiency) should be rewarded.

Supplemental Information

Person(s) and/or Organization(s) to Whom Statement Will Be Attributed

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